Capital One Financial Corporation
1680 Capital One Drive
McLean, VA 22102-3491

January 28, 2009

Senator Robert Menendez
United States Senate
317 Hart Senate Office Building
Washington, DC 20510-3005

RE: Implementation of new credit card regulations

Dear Senator Menendez:

On behalf of Capital One Financial Corporation ("Capital One") I greatly appreciate this opportunity to offer a response to your letter regarding the implementation of the recently adopted changes to the credit card rules. At Capital One we continuously review and adapt our policies and practices to keep up with legal and regulatory changes, the rigors of competition, the standards of sound banking, all within the context fairness and transparency for our customers.

Capital One is a financial holding company whose subsidiaries collectively had $109 billion in deposits and $147.3 billion in managed loans outstanding as of December 31, 2008. Headquartered in McLean, Virginia, Capital One has 739 branches in New York, New Jersey, Connecticut, Texas, Louisiana and Virginia. It is a diversified financial services company whose principal subsidiaries, Capital One, N.A., Capital One Bank (USA), N. A., and Capital One Auto Finance, Inc., offer a broad spectrum of financial products and services to consumers, small businesses and commercial clients. Among its product lines, Capital One is one of the largest issuers of Visa and MasterCard credit cards in the world. A Fortune 500 company, Capital One trades on the New York Stock Exchange under the symbol "COF" and is included in the S&P 100 index.

Capital One appreciates your interest in the current and future state of credit card practices. We are also very sensitive to the requests you make on behalf of American consumers. These are matters of great importance to the U.S. economy, particularly in light of the unprecedented economic challenges facing our country. With the information below, we have attempted to address the various concerns expressed in your letter. It is my sincere hope that this provides you with a better understanding of Capital One's approach to the new credit card regulations, as well as consumer protection more generally.

1. <u>The new federal regulations dramatically alter nearly every aspect of credit card offers and programs, and will require extensive efforts to implement.</u>

On December 18, 2008, the Federal Reserve together with other banking agencies released a final, comprehensive set of credit card regulations calling for unparalleled levels of consumer protections and card disclosures. Specifically, there have been significant amendments to Regulation AA (Unfair or Deceptive Acts or Practices) and Regulation Z (Truth-In-Lending). The following is an abbreviated list of the combined new requirements:

- Payments must be allocated among balances with different interest rates using one of two methods (neither which is prevalent today).
- Existing account balances simply cannot be repriced in most cases.
- Double-cycle billing is prohibited.
- Monthly statements need to be mailed at least 21 days before the due date.
- The following documents will now look different and require other information:
    - Application and solicitation disclosures.
    - Account opening disclosures.
    - Monthly statements.
    - Change in terms notices.
    - Penalty rate notices.
    - Convenience and access checks.
- 45 days prior written notice is required before any change in terms.
- Rates that are marketed as "fixed" cannot change for any reason.
- Payments cannot be due on days that mail or payments are not processed.
- Payments are on time if received by 5 pm on the due date.
- Active accounts cannot be terminated due to lack of finance charges.
- Billing errors resolution timelines impose more liability on card issuers.

As you note in your letter, Regulation AA curbs a number of practices that are expressly permitted by law today. In fact, many of them became standard industry practices years ago, and have a firm basis in sound risk management principles. In addition, amendments to Regulation Z restrict other practices not addressed by Regulation AA, and require extensive changes to the format, timing and content requirements for all routine and specialized credit card disclosures.

As discussed in more detail below, many of the provisions in the new rules relate to practices in which Capital One has never engaged, including prohibitions on "universal default" and double-cycle billing. We are proud of the fact that these prohibitions will not impact us, and thus will not require any modifications to our systems or business practices.

Nevertheless, Capital One and other issuers will be challenged to meet the required July 1, 2010 implementation deadline. Capital One and the entire industry will have to make sweeping and fundamental changes to credit card operations, customer communication materials, solicitations, applications, welcome letters and periodic statements. These rules will require significant changes to account acquisition and account management strategies. There will also be extensive overhauls of the disclosures provided over the life cycle of credit card accounts from marketing stage through closing. Marketing and account management communications will need to be completely redesigned to accommodate the new disclosures and formats. Dozens of systems and processes will need to be altered or enhanced to accommodate these requirements.

The implementation of the new regulations will be a substantial undertaking. Capital One is prepared to make a substantial commitment of time, dedicated personnel and financial resources to ensure that our work is completed properly and on time. In fact, we have already launched a company-wide effort to initiate the implementation process as quickly and practically as possible, with the goal of being in full compliance by July 1, 2010. Under the circumstances, it would be imprudent, and likely impossible, for us to commit to a more aggressive implementation completion timeline than the one afforded by the regulations themselves.

The 18 month implementation timeline represents an explicit acknowledgement by those within the federal government who understand the complexity of the changes that the rules will have far reaching strategic, financial, accounting, contractual, compliance, systems and operational impacts. The Federal Reserve Director of Consumer and Community Affair, Sandra Braunstein, has specifically acknowledged that, "card issuers are going to need to rethink their entire business models, they're going to need to reprogram all their systems, they're going to have to redesign their marketing materials, their solicitations, their periodic statements – all the pieces of paper that they use – their contracts." The Federal Reserve also appreciates that it will not be possible to implement any one change in isolation of others since they are all interrelated. Not surprisingly, Director Braunstein concluded that, ". . . considering everything that needs to be done and the interconnectedness of the different rules, we think that 18 months is a very reasonable time period. In fact, 18 months is a challenge."

2. <u>Capital One has a strong track record of voluntarily adopting industry leading credit card practices. We remain firmly committed to fair and honest dealings with our customers.</u>

Capital One shares your view that, the credit card industry must be increasingly proactive in aiding the stability of consumer finance, At Capital One we regard the new rules as another opportunity to advance our longstanding mission of creating credit card products and services that provide great value without the hassle. We strongly believe that it is in our best interest to ensure that our customers understand our products and services and make informed decisions that enable them to successfully manage their personal finances. For a number of years Capital One has maintained critical policies and practices that we believe to be essential to the empowerment of our customers and the health of our industry. These consumer-centric priorities have helped to differentiate Capital One and many have put us in compliance with key elements of the new regulations already:

- Simple and timely disclosures; plain English notices and easy to read information delivered to customers at the moment when they are most relevant. In fact, the quality and transparency of our disclosures have been noted by several Members of Congress, as well as consumer groups and regulators.
- No aggressive ("hair trigger") default repricing. Capital One has only one default repricing policy. We only reprice a customer who has paid at least 3 days late twice in

a twelve month period. After the first infraction, we provide a prominent warning on their monthly bill alerting them that they may be repriced if they pay late again.
- Allowing customers who have been default repriced to earn back their prior rate by simply paying us on time for twelve consecutive months.
- Not practicing any form of "universal default" (whereby a customer can be repriced because of a drop in credit score, or as a result of paying late or exceeding the credit limit on a different account).
- Providing customers with 45 days advance notice of a non-default change in terms to their accounts. We also give these customers a fair choice; they can accept the new terms and continue to use their cards, or simply reject the changes and pay down any existing balances at their current terms with no time limit.
- Warning customers who routinely make just the minimum payment about the long term financial consequences of paying down too slowly.

Capital One continuously seeks out ways to improve our communications with our customers and review our policies and practices. The reality is that in a highly competitive market, we must continuously strive to improve our products and services if we are to attract and retain the best customers.

3. <u>To the extent possible, Capital One will find ways to refrain from increasing the rates on many accounts. However, the convergence of deteriorating credit quality, a non-functioning asset backed securities market, and the general recessionary outlook demand that we undertake future repricing action for certain segments of our portfolio.</u>

Unlike most other major credit card issuers, Capital One did not increase the interest rates of its credit card customers in all of 2008 absent an individual customer's violation of his or her credit card agreement. All interest rate changes in the past year have resulted from either default repricing following a customer's violation of the very clear and narrow default repricing policy described above, or, in the case of variable rate products, movements in the underlying index rate such as the Prime rate.

Many Capital One customers have also seen their credit card rates drop during the past year as the Prime rate has decreased in response to policy moves by the Federal Reserve Board. In fact, annual percentage rates for variable rate accounts tied to the Prime rate have decreased by 4 percentage points since January 1, 2008 – the full amount of the decrease in the federal funds rate. These accounts make up almost half of Capital One's consumer credit card assets.

By contrast, the costs of Capital One's funding for credit card assets have not experienced similar or proportional decreases. While Capital One's access to diversified funding sources allows us to continue to extend credit during these challenging times, it is important to note that the lowering of the federal funds rate has not eased or restored the funding traditionally available to lenders in the securitization markets. In short, Capital One's funding in the securitization market is not tied to the Prime rate or any similar index. Such funding is priced on the basis of the market's perceived risk of the underlying portfolio. Thus, notwithstanding decreases in the federal funds rate, when credit losses rise as they have done so dramatically, pricing for our market-based funding rises as well.

The current economic outlook continues to deteriorate rapidly and consumer defaults on credit card loans are increasing significantly. As such, we believe that it is imperative that credit card issuers maintain a reasonable degree of flexibility to reprice accounts to reflect the risk environment and maintain the safety and soundness of our financial institutions. We must act responsibly over the next year by considering changes to accounts whose terms do not appropriately reflect these increased risks, or are simply misaligned with the new regulatory structure. We note that the Federal Reserve, in releasing its final rules, expressly recognized the need for credit card issuers to reprice many accounts to reflect the dramatically altered environment.

As always, such actions will be conducted in a manner consistent with our long-standing principles of fairness, clarity and transparency, including offering all affected consumers 45-days advance notice and the opportunity to opt-out of any interest rate increases and pay down their balances over time at their existing rate. As previously noted, the 45 day advance notice reflects our existing policy, and is fully compliant with the Federal Reserve's new requirements. We note that the opt-out right, which also reflects our long-standing policy, is not required by the new rules.

4. <u>Capital One takes our role as a community leader and educator very seriously. We will continue to work with consumers and lawmakers to ensure sound information and products remain in the marketplace.</u>

At Capital One we believe financial literacy is vitally important to the financial well-being of all Americans and we are committed to helping improve financial literacy skills in communities across the country. Through partnerships with leading non-profit organizations, Capital One has developed a multi-faceted set of programs to promote financial literacy and deliver financial education tools, particularly among low- and moderate-income populations.

Capital One partners with Junior Achievement (JA) on a number initiatives intended to help prepare students from low- and moderate-income families to make smart financial decisions as adults. Our signature program, Finance Park, is a unique, mobile program travels to select cities to provide students the opportunity to experience a day-in-the-life of an adult. The goal is to introduce fifth through eighth-grade students to money management basics.

Capital One partners with Consumer Action, a national non-profit organization dedicated to advancing consumer rights through education, to produce and distribute the "MoneyWi$e" series of financial education materials to consumers. The MoneyWi$e program includes informational brochures, train-the-trainer guides, lecture curriculums and computer based trainings available in English and Spanish.

In 2008, Capital One opened our second student run bank branch, this one in West Side High School in Newark, New Jersey. The branch is operated by student bankers with management for the branch provided by associates from Capital One Bank. Student bankers will participate in educating peers on financial education and encourage them to establish savings plans; the branch offers a limited menu of products designed primarily for student savers.

Once again, on behalf of Capital One I wish to thank you for the opportunity to provide this information. We appreciate your concern for, and efforts to better understand, issues of great importance to Capital One, the entire credit card industry and its customers. We would be happy to discuss this matter in greater detail with your staff at your convenience

Sincerely,

Ryan Schneider
President, Card